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FAX TRANSMITTAL SHEET

February 25, 2004

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13 page(s) including cover

FROM: Timothy A. Tosta

IF YOU HAVE ANY QUESTIONS, PLEASE CALL THE FAX CENTER AT (415) 788-0900, ext. 4325.
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February 25, 2004

17179

Laurel Prevetti
Deputy Director
Planning Services
City of San Jose
801 North First St., Room 400
San Jose, CA 95110

Re: Strategic Economics Report - Building San Jose's Future
Jobs, Land Use, and Fiscal Issues in Key Employment
Areas, 2000-2020

Dear Ms. Prevetti

On behalf of our client, iStar Financial, Inc., we submit these comments and concerns on the draft report by Strategic Economics (et al) entitled "Building San Jose's Future: Jobs, Land Use, and Fiscal Issues in Key Employment Areas, 2000-2020". We raised some of these issues at the Developers' Roundtable meeting on February 13th. At your request, we have put these comments and issues in writing.

At the outset, we want to commend the City on its decision to commission this report to analyze economic information to help inform its land use decision-making. The report is ambitious and begins to address important and complicated issues.

Since the purpose of the report is to guide City decisions on land use and planning policy, it is critical that the report present accurate and reliable information, analysis and conclusions. Any flawed data and analysis could lead to incorrect, and possibly harmful, policy decisions. We believe that there are several significant errors in the data and analysis that undermine the report's conclusions and recommendations. For example, the report's data on job growth, industrial space vacancy, and absorption rates differ substantially from other reliable industry sources (which the report does not consider). Further, the report's recommendations are not supported by its own analysis in several places.

One of our central concerns is the report's recommendation that vacant land in certain subareas be preserved for industrial development. We believe that the report greatly overestimates the need for vacant industrial land for future job growth for a variety of reasons discussed below. This presents a serious problem of excess vacant industrial land remaining undeveloped for the foreseeable future when currently there is a shortage of vacant land to meet

Laurel Prevetti
February 25, 2004
Page Two

the identified need for retail and housing development. As a result, the City will continue to suffer significant adverse fiscal impacts on two fronts: (1) retail sales leakage and housing shortages (including, related housing affordability) due to insufficient land to meet demand for retail and housing development; and (2) ongoing public costs and lost public revenue (i.e., property tax, sales tax, and others) from vacant, undeveloped property.

Below is a summary of our main issues and concerns. A more detailed discussion of these issues prepared by Brion & Associates (an economic consultant) is attached. We urge the City to seriously consider these deficiencies before using the report to assist future land use decision-making.

1. Future Job Growth is Significantly Overstated Resulting in the Identification of Excess Industrial Land Needed for Preservation

- The report's projections for future job growth (which are based on ABAG data) are wildly optimistic compared to future job projections by other industry sources. Between 2000 and 2020, ABAG projects job growth of 123,400 jobs for the City, 141,000 jobs for the City and its Sphere of Influence, and 270,500 jobs for Santa Clara County. By comparison, Economy.com (a leading, nationally recognized economic forecasting firm) forecasts total employment of only 34,800 jobs for Santa Clara County – 87% less than ABAG's projection. Using the ABAG ratio of City jobs to County jobs, Economy.com forecasts job growth of only 18,000 jobs for San Jose over the next 20 years. If Economy.com's forecast of job growth is used, only 10 % of the report's calculation of vacant land is needed for employment growth and land need for preservation is overstated by at least 1,000 acres. This would significantly change the conclusion of the report that there is just enough (or slightly less) land available to meet job growth.

The report's job growth projections also are too high because it does not account for the severe job loss in the Silicon Valley over the last few years and assumes recovery of almost all of these jobs in the next couple of years. For example, ABAG projects total Santa Clara County employment in 2005 that is only 6,000 jobs less than the pre-recession job levels in 2000. Economy.com predicts 2000 employment levels will not be reached in the County until about 2017. Thus, ABAG's job growth projections do not fully take into account the extent of the recession and the "jobless recovery" to-date (i.e., business activity is increasing but no significant new jobs are being created). If these factors are considered, there will be significantly less job growth and significantly less need for industrial land by 2020 than that presented in the report.

Laurel Prevetti
February 25, 2004
Page Three

2. The Current Available Supply of Industrial Land is Understated Which Artificially Accelerates the Timeframe for Absorption of Available Land

- Coyote Valley and Evergreen should be included in the report's analysis of available employment land because industrial development is permitted in these areas under the City's planning documents. Coyote Valley and Evergreen would add approximately 1,700 acres of available industrial land. This increases available supply to about 3,261 acres instead of the estimated 1,561 in the report.
- The existing available supply is underestimated because of the exclusion of obsolete space and the undercounting of phantom space, the latter of which is a significant reality in the current market and represents additional unused inventory. With regard to obsolete space, it is our understanding that the brokerage data used already excludes obsolete space, so an additional exclusion is unwarranted. In addition, any discussion of potentially obsolete space should consider that such space will be redeveloped or reused, especially since it presents lower rental rates in a price-sensitive market.
- The industrial land supply in Silicon Valley as a whole should be considered because the real estate market is not localized to San Jose. The report's exclusion of the significant amount of industrial land available in Silicon Valley results in a projection of faster absorption of this space in San Jose.

3. Industrial Land Requirements for Future Growth are Over-estimated Due to Faulty Assumptions and Methodologies

- The projections for future industrial land requirements are completely supply driven and do not address market demand. There may be supply in the employment areas that is not competitive or well suited to R&D or office and better situated for other uses. The report should have a market-demand analysis and then compare that demand to available supply.

The amount of industrial land required for future growth is 450 acres greater than the acreage presented in the recent Economic Development Strategy prepared for the City. There is no explanation of this discrepancy.

- The need for industrial land is overstated because the analysis does not consider higher density development (i.e., higher FAR), the more efficient use of space (i.e., more employees per square foot), and the current "jobless recovery".

4. The Report Inadequately Addresses the Differing Demand for Industrial Land in Different Areas

The historical demand patterns in different City and regional areas should be considered. For example, given the regional high vacancy rates, more desirable areas (such as North San Jose and Downtown) will be absorbed first due to better proximity to labor and

Laurel Prevetti
February 25, 2004
Page Four

housing, and less desirable areas (such as Edenvale and Monterey Corridors) will be absorbed much later. These facts can be established by analyzing historical information on absorption, occupancy and vacancy rates for various areas.

The report treats all land in all subareas as having equal value and potential, which is not true. Within the City, the report treats all industrial land equally from a supply standpoint, but the market does not treat land in different areas equally from a demand standpoint. The market has shown strong preferences for areas, such as Downtown and N. First Street. Other areas, such as Edenvale, have performed poorly over the years despite significant City investment.

5. Although the Report Identifies the Need for Retail Development, It Does Not Identify Adequate Land Available to Meet Retail Development Need

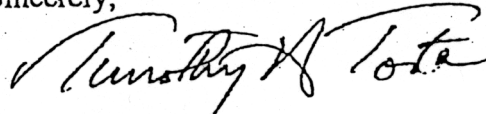
- The report identifies significant need for retail development within the City, but does not identify how this need will be met. The City is experiencing significant retail sales tax leakage. The report should identify the land needed for retail development to meet the demands of City residents.

In summary, these problems with the report lead to a land use policy direction that is not supported by the data or rigorous analysis. The report's conclusion that very limited conversions should be allowed because there is just enough "vacant employment land" to accommodate job growth over the next 20 years will result in adverse economic consequences for the City and poor planning decisions.

We strongly recommend that the City consider having the study revised based on these comments and others raised by the development community at the Roundtable meeting before relying on its content for any land use policy decision.

We appreciate the opportunity to comment on the report. Please call us with any questions about this letter.

Sincerely,



Timothy A. Tosta

Attachment

cc: Honorable Mayor and Members of the City Council



BRION & ASSOCIATES

Comments and Questions on
"Building San Jose's Future: Jobs, Land Use, and Fiscal Issues in Key Employment
Areas, 2000-2020"

Prepared by Strategic Economics et al
February 2004

At the outset we want to commend the city for undertaking this important study. The issues of conversions are the key planning and economic issue facing the City. This is particularly true in light of the significant budget constraints faced by the City. Continued development will be an important part of the City's strategy to weather this economic downturn. We do understand the concerns and need for the analysis. However, we unfortunately have significant concerns about the study as both a policy and planning tool. Our specific comments are presented in an effort to convey a message that shows that the analysis is critically sensitive to the assumptions that are made about growth, density, supply, and other economic data. We have highlighted this at the end of the letter with a summary of how changes to three key assumptions or use of an alternative valid data source would greatly change the outcomes of the study and its recommendations.

The study does provide the City with a new way to view its economy which will be useful, such as viewing jobs in terms of driving industries and support industries. This concept is useful in that it presents some of the more complex economic relationships embedded in input-output analysis and simplifies them in terms that the public can understand. We support this type of analysis and the restructuring of the ABAG's forecast but question many other assumptions and data, and then the ensuing conclusions. Time prevents us from supplying you with detailed alternative analyses and we have not provided detailed text edits and comments. But, we have tried to summarize our comments into main issues of concern that directly impact the results and conclusions of the study.

Supply and Demand Land Analysis Comments

- ❖ **Supply Driven Analysis:** The analysis is completely a supply driven forecast of demand. Not only is the current distribution of existing supply driving the projected need for land, but the current mix of employment is presented to be optimal, when in fact it represents suboptimal conditions, i.e., a recession. Too much weight is placed on existing conditions and no assessment of historical trends has been conducted.

*Comments of Fiscal Impact Study
By Brion & Associates*

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- ❖ **ABAG forecast is wildly optimistic.** Other forecasts project much less job growth for the San Jose metro area. Economy.com forecasts 35,000 jobs for the same period and the metro area, which is mostly Santa Clara County. This is 100,000 less jobs than ABAG's forecast. The analysis has to look at other forecasts for the analysis, including Economy.com and UCLA's forecast. The implications of Economy.com's lower forecast are discussed below, including how it significantly would change the conclusion of the study.
 - ❖ **Forecast Geography is inconsistent.** The forecast uses the projected job growth for San Jose and its sphere of influence but applies this forecast to the jurisdictional boundary, which excludes areas like Coyote Valley and Evergreen. The forecast for the jurisdictional boundary is about 123,000 new jobs, and using a simple average of 358 sqft per employee would require about 6.3 million less sqft or 242 acres less of land. If the 141,000 forecast figure is used, it needs to be compared to the supply in the sphere of influence, at a minimum.
 - ❖ **No Historical Trends Analysis:** There is no analysis of historical growth and absorption by subarea and no analysis of the relatively competitiveness of various subareas for the uses that are targeted in each area. Again existing conditions are extrapolated to present complete and optimal demand. Critical questions that have not been asked include:
 1. What were the trends with development in these subareas?
 2. What types of uses were developed?
 3. What was the average size of development?
 4. How much redevelopment occurred at the peak of the dot.com era?
 5. How much raw land was consumed?
 6. Which subareas were hot at the peak of demand, and which ones were not and why?

All vacant land is treated equally, or implied to have equal importance, as if it were all comparable, which we know is not true. Some areas are more desirable than others and some subareas have languished for years, such as Edenvale, despite significant investment by the City Redevelopment Agency.

The subarea level recommendations are not supported by the analysis presented, in part because the analysis does not answer these above questions.

- ❖ **Allocations of Employment Growth:** The 21 active employment subareas comprise 54% of current employment -- thus, 46% of current employment or about 163,600 jobs are outside these areas. The entire 2000-2020 forecast is allocated to the 21 subareas, by implication, this job growth requires 1,412 acres, but there is only 1,250 useable acres in the subareas, according to the City's report. Some of the job growth needs to be allocated to areas outside the 21 subareas, and infill development will continue to take place outside these areas.

This is derived from the City's analysis.

*Comments of Fiscal Impact Study
By Brion & Associates*

There is no consideration of vacant parcels outside the 21 subareas or redevelopment opportunities in other parts of the city.

The analysis states the 72% of the city's driving industries are located in the 21 subareas; if this is true, then only 72% of the forecasted jobs in driving industries should be presumed to develop in these areas. Some firms and developers will chose to develop outside these subareas for a variety of reasons.

- ❖ **No Sensitivity Analysis:** The analysis needs to include a sensitivity analysis of various key assumptions, including sqft per employee, FARs, the inclusion of Coyote Valley and Evergreen figures into the supply, etc. The analysis should not rely on one data source or set of assumptions. Given the magnitude of assumptions that need to be made in this type of complex study, a range of results should be presented. This could take the form of a conservative and optimistic scenario.
- ❖ **Exclusion of Sphere of Influence:** The analysis completely dismisses the 1,700 acres in Evergreen and Coyote Valley - if these areas are included the City has more than twice the needed supply of employment lands, not presuming that some growth disburses through other areas. This dismissal is not justified or realistic. There are real plans to develop these areas.
- ❖ **Discounting Vacant Space:** In one section vacant space is greatly dismissed and in another stated to still be viable as owners can charge less rent and it can still be occupied. There are technical inconsistencies between the presumption that 18% of current listed vacant supply is obsolete and then the discussion that some older industrial space is still viable as it is offered at a lower rate and, therefore, may be found desirable by many firms.
- ❖ **Inappropriate Treatment of Vacant Space:** The analysis only uses one broker data source, Colliers International, and does not compare all the major brokerage data available, which can vary. Data from Cushman & Wakefield, CPS, and CB Commercial should be reviewed as there are many differences in these data sets, and some of them may include estimates of phantom space. In addition, brokerage data does not include "obsolete" space of the type that needs to be redeveloped and no one would rent. If the City presumes that 3.0 million sqft feet of space is obsolete, the analysis needs to assume that some of this would be redeveloped.

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*Comments of Fiscal Impact Study
By Brion & Associates*

- ❖ **Phantom Space² Omitted:** Phantom space is mentioned but dismissed. Various studies have estimated such space at 10 to 15% of current vacant space. If this is true, then there is an additional 1.6 to 2.5 million more sqft of vacant space that is not being counted. Much of this phantom space will be coming on line in the near term as short term leases expire.
- ❖ **Retail Land Demand:** The demand for retail land should not be derived from an employment projection. We understand that the analysis is being consistent so that all the jobs are accounted for, but in determining the need for retail development, a market study that evaluates a number of factors, including household income, and current leakage needs to be used. Various recent retail studies, including the City's own studies conclude that there is significant retail sales leakage in the City and that retail is a key need for a variety of reasons.
- ❖ **Retail Study Not Released:** The study refers to a retail market study prepared for the City and not released to the public. This study, prepared by Bay Area Economics needs to be made available to the public.
- ❖ **Parcel Distributions:** The table with the distribution should be deleted from the report as it is completely misleading given that the size of parcels is not available which would truly give an indication of the concentrations of land use as noted in the appendix. This table suggests that 50% of the 21 subareas are residential.

Fiscal Impact Analysis

- ❖ **Analysis too Focused:** Because the study only analyzes four subareas, it cannot be used to inform decisions about conversions in other subareas. This is a key result of the approach taken and conclusion of the study that should be made clearer in the study. While we can understand the complexities of analyzing 21 subareas, it might have been more useful to analyze hypothetical individual project conversions rather than subareas.
- ❖ **Analysis not well documented:** The study authors state that the model methodology is proprietary and not pertinent to the analysis or results. This is a highly suspect statement. Without being able to review the model and the assumptions used, it is not possible to validate the analysis as being reasonable. Most fiscal impact studies include a print out of the entire model for this reason.
- ❖ **Analysis Too Complex:** Overall, the fiscal analysis is difficult to track and understand. The study does not present a clear list of cost and revenue assumptions for city services. Assumptions are woven throughout the report and appendices. A table summarizing the cost and revenue factors by city department

² Phantom space is space that is leased but not occupied and is not listed as available space although it is technically not occupied with employees; a significant portion of this space that was leased around 2000 will start to come into the market in coming years.

*Comments of Fiscal Impact Study
By Brion & Associates*

needs to be provided, and on a "per population, per employee or per service population" basis. Without detail on the model methodology and cost factors, it is difficult to impossible to derive any use of the analysis for other subareas.

- ❖ **Summing of Annual Fiscal Benefits or Costs:** The report summarizes fiscal benefits over a 20 year period for the subareas analyzed and various scenarios. In reality, this presents misleading information because these revenues do not accumulate over time, and they are spent each year. A better way and more accurate is perhaps to take a 20 year average of the fiscal impact and report this result.
- ❖ **Redevelopment:** The study presents a discussion of redevelopment that appears overly defensive. The benefits of "redevelopment" are perhaps overstated relative to the fiscal impacts of redevelopment on the General Fund. The reality is that development in redevelopment areas does not pay for the cost of city services from a general fund perspective, except when commercial uses are present.
- ❖ **Retail and Redevelopment:** It should be noted in the study, that retail development in redevelopment areas, is a key and important way to offset the negative fiscal aspects of redevelopment areas, i.e., that the property tax does not flow to the general fund. Retail development has low service costs and high revenue capabilities relative to housing and other uses.

Report Recommendations

- ❖ **Recommendations:** The report's recommendations are not supported by the report analysis. The report does not provide enough detailed analysis or historical analysis of each subarea to make the types of recommendations made for each subarea. This is true, despite the problems cited above. When considering these issues and problems raised above, it is extremely difficult to see how the recommendations are derived.
- ❖ **Recommendation #3 on page 22** is particularly confusing and unfocused and jumps around various topics. It is not clear if it is talking about non-residential land or residential land or both. It states that the City has tools to encourage more intense use of land but does not list or discuss them in the report. The last paragraph is very strange. What is "effective planning" and by who and under what terms?

Alternative Demand and Land Assumptions

The following table summarizes the City's approach and analysis with a few corrections, and contrasts these figures with alternative forecasts. Three major sections and corrections are presented although there are other more detailed corrections that could be analyzed such as changes to employee density assumptions. These changes can be summarized as follows:

*Comments of Fiscal Impact Study
By Brion & Associates*

1. Corrections for Vacant Space Distortions
2. Corrections for Aggressive Employment Growth
3. Correction of Sphere of Influence Exclusion

There are other corrections or changes we could suggest but these three corrections bracket the most important issues raised above and as shown, ones that directly impact the results and recommendations of the study.

1. Corrections for Vacant Space Distortions

This section shows how, if the 3.0 million sqft that is excluded from the City's analysis is added back into the analysis, and phantom space is included (at 10% of total vacant space), the City's analysis would require 782 acres of land instead of 1,412. It then shows that if another data set is used for vacant space, i.e., Cushman Wakefield, the need would be even lower, assuming phantom space, or 702 acres. This is half of what the City's study shows demand for office - R&D and industrial land to equal. These two changes would result in the need for only about 50% of currently available vacant land, excluding the land in the Sphere of Influence.

2. Corrections for Aggressive Employment Growth

These corrections shows how an alternative but equally respected forecast by Economy.com can significantly alter the results of the study. With projections of 35,000 jobs for Santa Clara County, and 18,140 jobs in San Jose (52% of the County) and assuming the same relationship between driving industries, support industries, etc, (53% of total jobs) from the City's study, the need for office-R&D land would equal 162 acres over the next 20 years, assuming no absorption of vacant space. In reality, the amount of current vacant space could more than accommodate the amount of job growth projected by Economy.com, from 2000 to 2020. Assuming that the City has 1,561 acres in the 21 employment areas, (this includes the 20% of parcels dismissed as too small or ill-configured), this demand for land would equal 20% of current supply. If the City's estimate of 1,250 acres is used, the Economy.com land demand of 162 acres would equal 10% of available supply, which is well enough to serve new demand and still leave land for beyond the 2020 time frame.

3. Correction of Sphere of Influence Exclusion

As shown, if the analysis simply included the 1,700 acres included in the City's sphere of influence, there would be about 3,260 acres of land available and the study's aggressive job growth would require only 43% of demand under the City's forecast and 5% of supply under a forecast prepared by us using Economy.com. With this simple change, the recommendations could not justify a policy of not allowing some conversions to take place.

*Comments of Fiscal Impact Study
By Brion & Associates*

Summary Conclusions

In summary, with a few simple corrections to the analysis presented by the City, wildly different conclusions and land use policies would be supported. The City's consultants may not be able to revise their study because of budget constraints but the City simply cannot use this analysis for the purpose of making important planning and land use decisions.

The City, like all cities in California, faces great economic challenges. If development totally stagnates in the City, many important industries will suffer, including the construction industry. There is currently is pent up demand for housing and retail uses. The City has great opportunities to meet this demand in a manner that will not compromise its long term ability to accommodate job growth. With a few simple changes to the City's study's assumptions, the recommendations would support conversions in a number of locations and for a number of uses.

Table 1

Implications of Other Forecasts and Key Assumptions
on the Recommendations of the "Building San Jose's Future" or the Fiscal Impact Study
City of San Jose

| Issues and Items | | City's Estimate w/ Adjustments (Collier's Intnt'l) (1) | Cushman Wakefield 4th Q - 2003 w/ Economy.com (2) | Comments & Notes |
|---|-----|--|---|---|
| <u>Corrections for Vacant Space Distortions</u> | | | | |
| Vacant Space (Supply) | | 13,645,000 | 18,400,000 | |
| Obsolete Space | | <u>3,000,000</u> | - | |
| Total Space | | 16,645,000 | 18,400,000 | |
| Additional Phantom Space | 10% | <u>1,664,500</u> | <u>1,840,000</u> | |
| Adjusted Vacant Space | | 18,309,500 | 20,240,000 | |
| City's projected space needs | | | | |
| 2000 to 2020 (Demand) | | 33,500,000 | 33,500,000 | This forecast is overstated as it presumes low employment density. This forecast is based on ABAG Projections 2003 and 141,000 new jobs, 2000-2020. |
| Absorbed Vacant Space | 90% | <u>16,478,550</u> | <u>18,216,000</u> | Assumes 90% of vacant space is absorbed |
| Net new space demand - 2000-2020 | | 17,021,450 | 15,284,000 | to leave a healthy vacancy rate of 10%. |
| <u>Presuming ABAG Forecast; and density/FAR assumptions in City's study</u> | | | | |
| City's estimate of Demand | | 1,412 | 1,412 | |

yes we
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2020/2030
study
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same

*Comments of Fiscal Impact Study
By Brion & Associates*

Continued.

| Issues and Items | City's Estimate w/ Adjustments (Collier's Intnt'l) (1) | Cushman Wakefield 4th Q - 2003 w/ Economy.com (2) | Comments & Notes |
|---|--|---|---|
| <u>Corrections for Aggressive Employment Growth</u> | | | |
| ABAG and Economy.com Forecasts - Jobs | 141,000 | 18,140 | from 2000-2020; E.com forecasts 34,500 jobs for Santa Clara Co. |
| Average space per employee | | 371 | Average of all city's density factors; all uses. |
| Project space need | | 6,729,844 | |
| Total need for land in acres (FAR) 50% | 2,688 | 309 | |
| City's Bus/Driving Industry Needs | 1,412 | na | Est. land requirements - from Table 13. |
| Percent Business/Driving (3) | 53% | 162 | Assumes same ratio of Bus/Driving need for Economy forecast; and no absorption of vacant space. |
| Existing Supply | 1,561 | 1,561 | Table 4 City's study; including small parcels. |
| <u>Correction for Sphere Exclusion</u> | | | |
| Supply in Active Employment Areas | 1,561 | 1,561 | |
| Coyote Valley & Evergreen | 1,700 | 1,700 | |
| Total with Sphere of Influence | 3,261 | 3,261 | Supply is over double what is rep in City's Study |
| Demand for Office/Industrial Land | 1,412 | 162 | |

(1) Most of this data is taken directly from the City's study "Building San Jose's Future: Jobs, Land Use, and Fiscal Issues in Key Employment Areas, 2000-2020" prepared for the City of San Jose by Strategic Economics, Hamilton, Rabinovitz & Alschuler, Inc. Urban Explorer, Whitney & Whitney, Inc. (February 2004)

As noted adjustments are made to data from this study for illustrative purposes.

(2) This alternative estimate of demand for land is based on a forecast by Economy.com, and use of Cushman Wakefield brokerage data.

(3) The ratio here is the amount of land needed for business support and driving industries as a % of total land need in the City's report.

Economy.com does not forecast job growth in these categories for direct comparison is not possible.

Sources: City of San Jose; Strategic Economics et al; Cushman & Wakefield; Economy.com; Brion & Associates.